TSX-V PER

2007 ANNUAL REPORT

petro-reef resources ltd.

PETRO-REEF RESOURCES LTD.

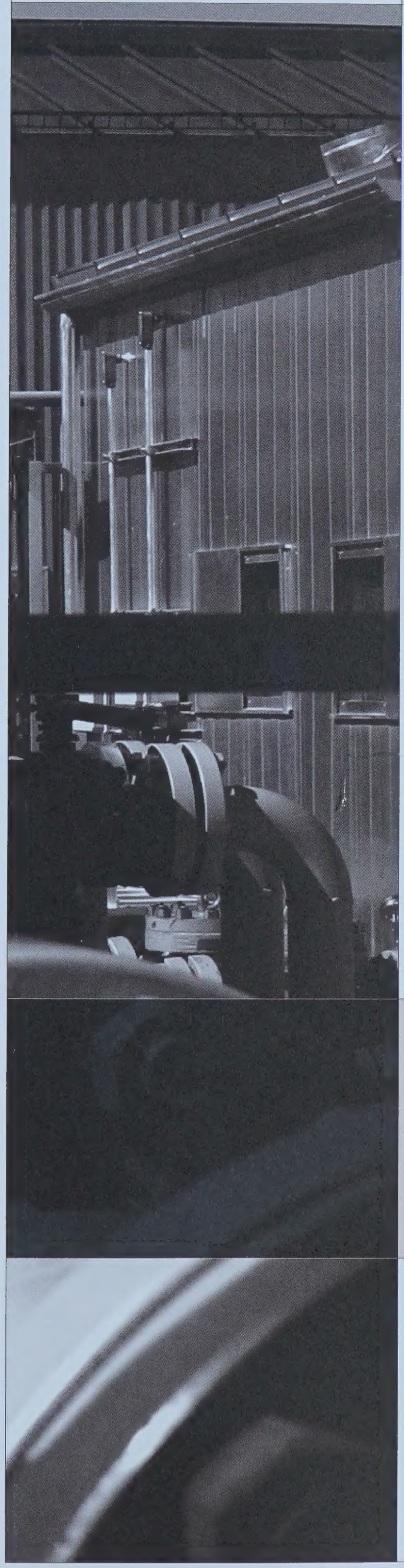
TSX-V PER

petro-reef
resources ltd.

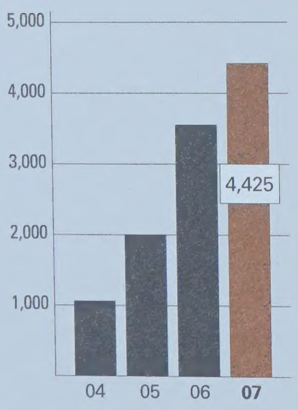
Petro-Reef Resources Ltd. is a Calgary-based crude oil and natural gas exploration and production company with producing properties in Alberta, Canada.

Petro-Reef operates two core properties, Alexander Qui-Barre and Peavey/Morinville. The Company's remaining production comes from minor working interests and royalty properties.

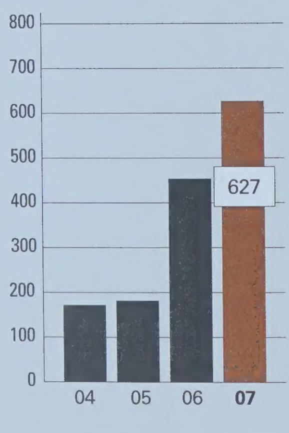
TABLE OF CONTENTS



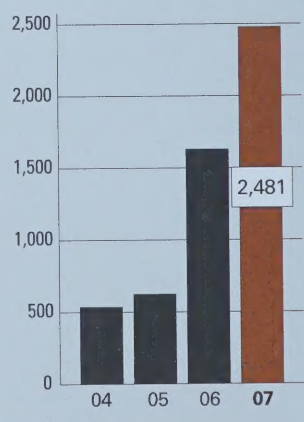
CASH FLOW FROM OPERATIONS
(000's)



PRODUCTION
(BOED)



PROVED PLUS
PROBABLE RESERVES
(MBOE)



FINANCIAL HIGHLIGHTS

	2007	2006	% Change	2005
FINANCIAL				
Revenue	**$ 9,289,499**	$ 7,156,594	29.8%	$ 3,798,272
Cash Flow From Operations	**$ 4,403,135**	$ 3,557,432	23.8%	$ 2,007,713
Cash Flow Per Share (Basic)	**$ 0.137**	$ 0.159	-13.8%	$ 0.106
Net Earnings (Loss)	**$ (357,550)**	$ 65,060	n/a	$ 247,714
Net Earnings (Loss) Per Share	**$ (0.01)**	$ 0.003	n/a	$ 0.013
Capital Expenditures	**$ 10,704,869**	$ 7,888,288	35.7%	$ 2,374,843
Bank Balance (Loan)	**$ 4,921,309**	$ (376,613)	n/a	$ 397,904
Shareholder Equity	**$ 19,483,847**	$ 7,919,194	146.0%	$ 6,029,968
Common Shares Outstanding				
End of Period	**33,714,781**	23,685,291	42.3%	21,438,924
Weighted Average	**32,198,063**	22,313,869	44.3%	18,994,641
Average Selling Price				
Natural Gas ($ / mcf)	**$ 6.57**	$ 7.16	-8.2%	$ 9.57
OPERATIONS				
Average Production				
Crude Oil and NGL's (bbls / day)	**29**	25	17.1%	2
Natural gas (Mcf / day)	**3,591**	2,575	39.5%	1,080
Total Production (BOE / Day)	**627**	454	38.3%	182
Operating Costs ($ / BOE)	**$ 7.85**	$ 9.07	-13.4%	$ 11.43
RESERVES				
Proved Plus Probable (Forecast Prices)				
NI 51-101 Compliant	**2,485,800**	1,632,400	52.2%	626,400
Present Value of Reserves				
Before Tax Discounted at 10%				
NI 51-101 Compliant	**$ 50,661,000**	$ 32,025,000	58.2%	$ 17,336,000

PRESIDENT'S MESSAGE

2007 was a year of tremendous change for Petro-Reef Resources Ltd. A combination of low natural gas prices, uncertainty in capital markets and the Alberta Government's decision to increase royalties required Petro-Reef to adapt to a changing environment. In the face of such uncertainty, Petro-Reef achieved significant milestones, the combination of which has laid the framework for even more significant growth in 2008 and beyond. In 2007, Petro-Reef experienced strong production growth as the exit production volumes were over 100% above the 2006 exit production volumes, with average production increasing over 38%. During the year, Petro-Reef drilled eight successful wells, including the drilling, completion and tie-in of our highest producing well at 13-06. This well which has maintained a production volume in excess of 3.0 mmcf/d (gross) since being brought onstream in October 2007.

In 2007, Petro-Reef centralized natural gas processing and compression for the Alexander Qui-Barre field at the 8-1 facility with the commission of a new 1,280 bhp compressor with capacity of 12.5 mmcf/d. The commissioning of the 8-1 facility allowed for real operational synergies as five smaller facilities were consolidated into one. Operating costs have been steadily decreasing, with December 2007 operating costs averaging approximately $6.25 / boe as a result of the consolidation and increasing production.

At a time when competitors were increasing their debt to finance drilling operations, Petro-Reef prudently incurred capital expenditures recognizing opportunities would present themselves to companies who had available cash. Petro-Reef was rewarded for its prudence. With cash and bank credit facilities available, Petro-Reef completed a strategic acquisition of a working interest partner in our core area of Alexander Qui-Barre. Not only did we acquire over 400 boe/d of long life, low cost crude oil and natural gas production, we acquired the key to continued growth...undeveloped land. As a result of the acquisition, Petro-Reef increased its working interest to over 75% on existing producing assets and to 80% to 100% on key sections of undeveloped land where Petro-Reef has identified 10 to15 development oil locations and 8-10 natural gas prospects, several of which will be drilled in the coming months.

Focusing on exploration drilling and the completion of key infrastructure projects in 2007 has paved the way to continued growth through 2008 and beyond. Petro-Reef has an aggressive drilling program planned for 2008, balancing low risk crude oil development opportunities with natural gas targets which individually, have the ability to increase production and reserves. By only drilling opportunities which meet a high rate of return and profit to risk ratio, Petro-Reef will maintain a strong balance sheet allowing for the pursuit of additional

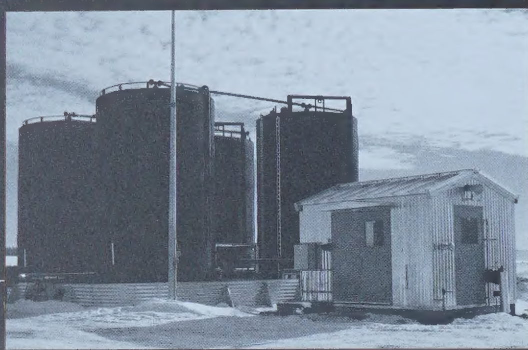
PRESIDENT'S MESSAGE

value added acquisition opportunities as they become available. Petro-Reef continues to acquire undeveloped land, both freehold and Crown and is actively shooting 3-D seismic over key sections allowing for the optimization of new drilling locations. With a current drilling inventory of over 30+ locations, Petro-Reef is well positioned for future growth.

We thank our shareholders for their continued support and look forward to celebrating a successful 2008.

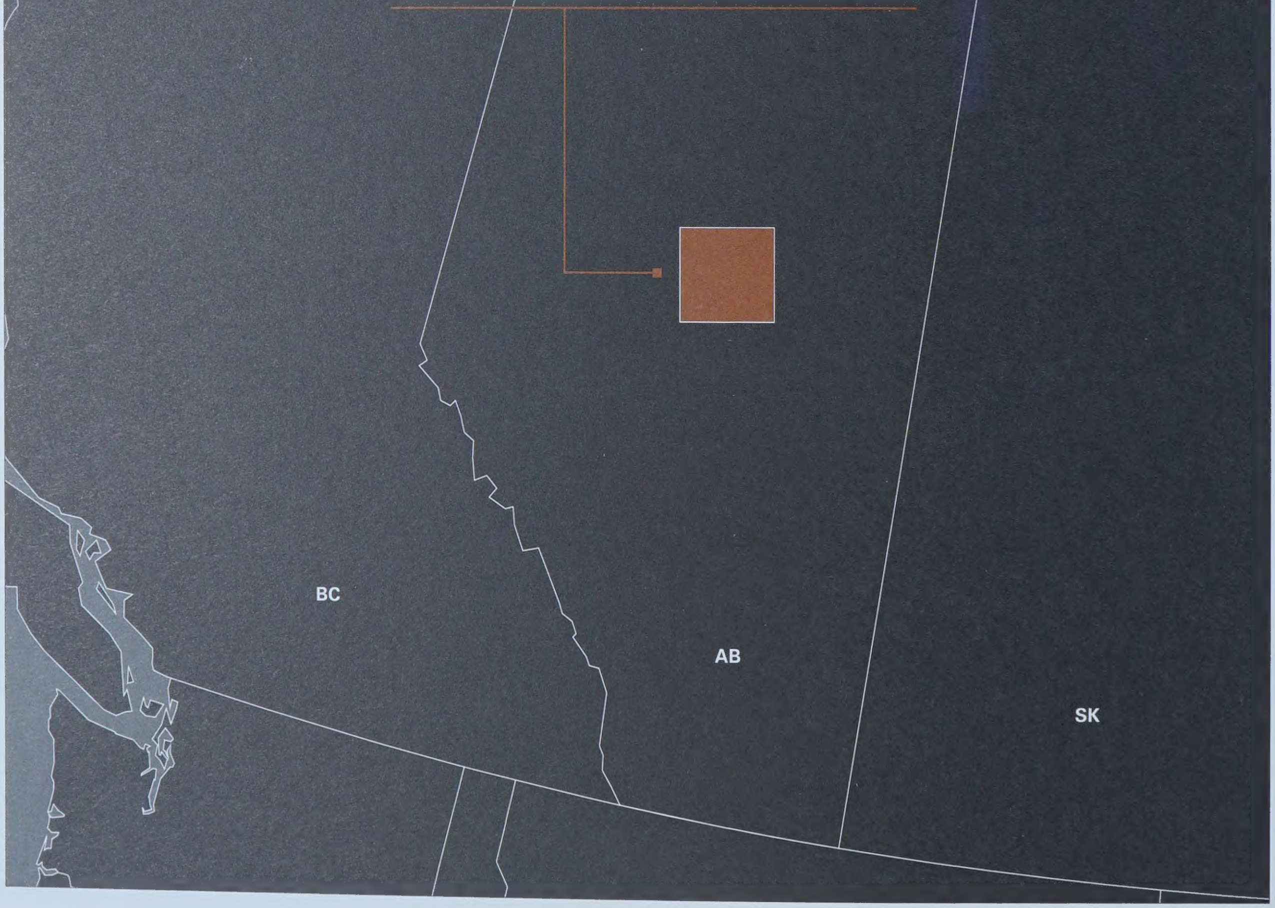
On behalf of the Management and Board of Directors,

JOSEPH WERNER | President and CEO



1 :: ALEXANDER QUI-BARRE

Average working interest: **75%**
Current Production: **1,350 boe/d**
Natural Gas Production: **6,300 mcf/d**
Crude Oil & NGL Production: **150 bbl/d**
Net P+P reserves: **2,400 mboe**



2007 OPERATIONS UPDATE

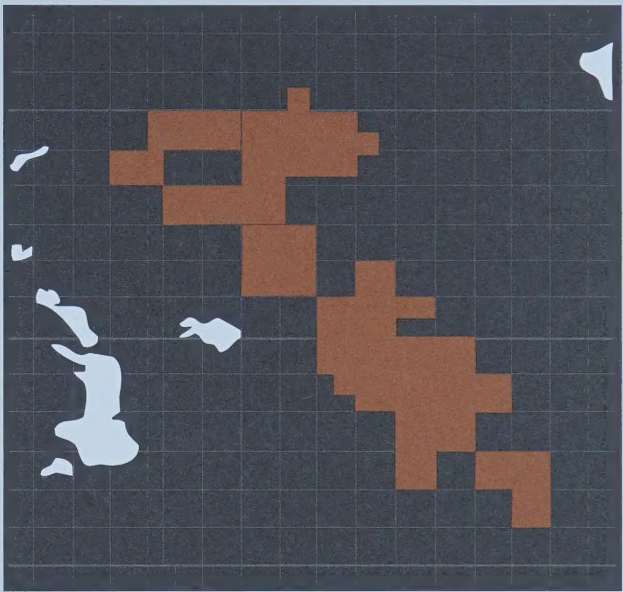
ALEXANDER QUI-BARRE, ALBERTA

Petro-Reef's core area of Alexander Qui-Barre is located approximately 50 kilometers northwest of Edmonton. This high impact, multi-zone area is strategically located close to infrastructure and services, allowing for significant cost savings both for capital projects and for day to day operations.

Petro-Reef has approximately 34 sections of undeveloped land in our core area of Alexander Qui-Barre, with an average working interest of 75%. Of the 34 sections, over half are on freehold royalty lands, meaning that Petro-Reef's total royalty payment is a maximum 25%, compared to the 46% proposed by the Government on sections of Crown lands. Petro-Reef is currently producing from 8 different zones, with several new, highly prospective zones waiting to be tested in 2008.

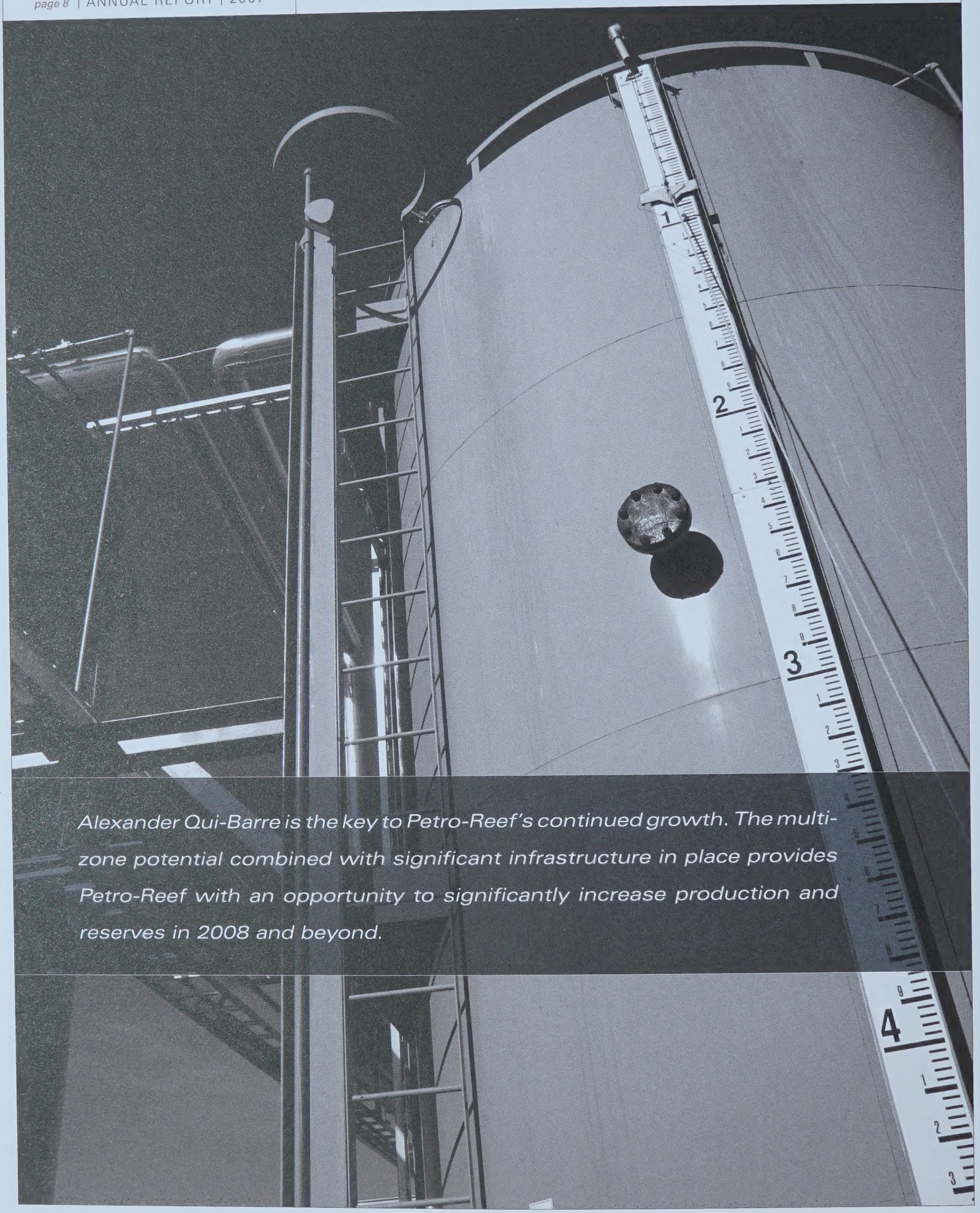
Petro-Reef has a large proprietary inventory of 2-D seismic and 3-D seismic coverage in Alexander Qui-Barre, all of which is owned and controlled by the Corporation ensuring no competitor has access to this information. Petro-Reef has recently completed a new 3-D seismic program over the key oil prospect located in section one.

ALEXANDER QUI-BARRE CORE AREA



Current production from the Alexander Qui-Barre area is approximately 1,350 boe/d, consisting of 200 bbls/d of light, sweet crude and approximately 7.0 mmcf/d of natural gas. Petro-Reef has identified over 30+ drilling locations in Alexander Qui-Barre, including approximately 20 development oil locations on sections where Petro-Reef has a 94% working interest.

The Alexander Qui-Barre area is characterized by long life, low cost production, as evidenced by Petro-Reef's current operating costs of approximately $6.25 / boe. Petro-Reef operates all production in Alexander Qui-Barre, including a 12.5 mmcf/d capacity and 5,000 bbls/d crude oil facility located at 8-1 where Petro-Reef has a 74% working interest. One of Petro-Reef's corporate strategies is to operate production and control infrastructure in the area. In Alexander Qui-Barre, Petro-Reef controls the key pipelines, gathering systems and facilities ensuring a competitive advantage relative to other companies. This competitive advantage allows for incremental production and reserves growth to occur in a cost effective manner as infrastructure is in place when new wells are drilled. Petro-Reef's Alexander Qui-Barre 8-1 facility is scaleable to 25.0 mmcf/d of capacity with the twinning of an existing compressor.



Alexander Qui-Barre is the key to Petro-Reef's continued growth. The multi-zone potential combined with significant infrastructure in place provides Petro-Reef with an opportunity to significantly increase production and reserves in 2008 and beyond.

RESERVES

Below is a summary of Petro-Reef's NI 51-101 compliant reserve report as evaluated by Sproule and Associates with an effective date of January 1, 2008 which includes the acquisition:

Reserves Category	Crude Oil (Mbbl)	Natural Gas (MMcf)	Natural Gas Liquids (Mbbl)	Total Jan 1, 2008 (MBOE)	Total Dec 31, 2006 (MBOE)
Proved					
Developed Producing	206.2	5,004	7.6	1,047.9	1,016.3
Developed Non-Producing	–	1,330	–	221.6	1.6
Undeveloped	152.5	2,378	–	548.8	425.3
Total Proved	**358.7**	**8,712**	**7.6**	**1,818.4**	**1,443.2**
Probable	253.8	2,469	2.1	667.4	189.2
Total Proved Plus Probable	**612.5**	**11,181**	**9.7**	**2,485.8**	**1,632.4**

Petro-Reef increased proved plus probable reserves by 52.2% to 2,485.8 MBOE. Petro-Reef's reserves are 75% natural gas, with 73% categorized as proven.

Below is a summary of the economic evaluation as prepared by Sproule and Associates with an effective date of January 1, 2008 which includes the acquisition of a working interest partner using December 31, 2007 forecast prices:

NET PRESENT VALUE BEFORE INCOME TAXES (M$)

	2007					2006
Reserves Category	**0%**	**5%**	**10%**	**15%**	**20%**	10%
Proved						
Developed Producing	$ 33,074	$ 28,389	$ 25,058	$ 22,576	$ 20,656	$ 20,790
Developed Non-Producing	$ 6,686	$ 5,132	$ 4,107	$ 3,392	$ 2,870	$ 15
Undeveloped	$ 15,674	$ 11,486	$ 8,710	$ 6,777	$ 5,375	$ 7,250
Total Proved	$ 55,434	$ 45,007	$ 37,876	$ 32,745	$ 28,900	$ 28,054
Probable	$ 22,321	$ 16,356	$ 12,785	$ 10,449	$ 8,811	$ 3,971
Total Proved Plus Probable	$ 77,755	$ 61,363	$ 50,661	$ 43,194	$ 37,711	$ 32,025

NET ASSET VALUE

A combination of exploration drilling, development of infrastructure and a strategic acquisition, Petro-Reef was able to significantly increase its net asset value. Below is a summary of Petro-Reef's estimated net asset value on an aggregate and per share basis.

As at January 1, 2008

	January 1 Pricing		March 31 Pricing	
	PV - Undiscounted	PV - 10%	PV - Undiscounted	PV - 10%
Assets				
Reserve Value (Proved + Probable) [1]	$ 77,755,000	$ 50,661,000	$ 86,084,000	$ 58,165,000
Undeveloped Land [2]	$ 6,281,595	$ 6,281,595	$ 6,281,595	$ 6,281,595
Seismic [2]	$ 1,417,417	$ 1,417,417	$ 1,417,417	$ 1,417,417
Total Assets	$ 85,454,012	$ 58,360,012	$ 93,783,012	$ 65,864,012
Liabilities				
Net Debt [3]	$ 120,357	$ 120,357	$ 120,357	$ 120,357
Acquisition Cost	$ 10,462,258	$ 10,462,258	$ 10,462,258	$ 10,462,258
Total Liabilities	$ 10,582,615	$ 10,582,615	$ 10,582,615	$ 10,582,615
Net Asset Value	**$ 74,871,397**	**$ 47,777,397**	**$ 83,200,397**	**$ 55,281,397**
Shares Outstanding	33,714,781	33,714,781	33,714,781	33,714,781
Net Asset Value Per Share	**$ 2.22**	**$ 1.42**	**$ 2.47**	**$ 1.64**

Notes:

(1) Reserves based on forecast prices. Includes acquisition.

(2) Book values as at December 31, 2007.

(3) Includes bank debt and working capital deficit.

MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis ("MDandA") of financial condition, future prospects and results of operations of Petro-Reef Resources Ltd. ("Petro-Reef" or the "Corporation") is dated April 24, 2008. It should be read in conjunction with the audited annual consolidated financial statements and corresponding notes for the twelve month period ended December 31, 2007 and with the audited year end consolidated financial statements of the Corporation for the year ended December 31, 2006.

The financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. When alternative accounting methods exist, management has chosen those methods it deems most appropriate in the circumstances. Financial statements are not precise since they include certain amounts based on estimates and judgments. Management has determined such amounts on a reasonable basis in order to ensure that the financial statements are presented fairly, in all material respects. The financial information contained elsewhere in this report has been revised to ensure consistency with the financial statements.

Management has established systems of internal controls, which are designed to provide reasonable assurance the Corporation's assets are safeguarded from loss or unauthorized use and to produce reliable accounting records for the preparation of financial information.

Petro-Reef's Board of Directors and Audit Committee have reviewed and approved the December 31, 2007 annual consolidated financial statements and related MDandA.

This MDandA provides certain financial measures that do not have a standardized meaning prescribed by Canadian generally accepted accounting principles ("GAAP"). These non-GAAP financial measures may not be comparable to similar measures presented by other issuers. Cash flow from operations and operating netback are not recognized measures under GAAP. Management believes that in addition to net income, funds from operations and operating netback are useful supplemental measures as they demonstrate the Corporation's ability to generate the cash necessary to repay debt or fund future growth through capital investment. Investors are cautioned, however, that these measures should not be construed as an alternative to net income determined in accordance with GAAP as an indication of Petro-Reef's performance. Petro-Reef's method of calculating these measures may differ from other companies and accordingly, they may not be comparable to measures used by other companies. Operating netback is calculated on a $/boe basis and is defined as revenue less royalties and operating expenses.

FORWARD LOOKING ADVISORY

Some of the statements contained herein (including without limitation, financial and business prospects and financial outlooks) may be forward-looking statements which reflect management's expectations regarding future plans and intentions, growth, results of operations, performance and business prospects and opportunities. Words such as "may", "will", "should", "could", "anticipate", "believe", "expect", "intend", "plan", "potential", continue" and similar expressions have been used to identify these forward-looking statements. These statements reflect management's current beliefs and are based on information currently available to management. Forward-looking statements involve significant risk and uncertainties. A number of factors could cause actual results to differ materially from the results discussed in the forward-looking statements including, but not limited to, changes in general economic and market conditions and other risk factors. Although the forward-looking statements contained herein are based upon what management believes to be reasonable assumptions, management cannot assure that actual results will be consistent with these forward-looking statements. Investors should not place undue reliance on forward-looking statements. These forward-looking statements are made as of the date hereof and the Corporation assumes no obligation except as required by law to update or review them to reflect new events or circumstances.

Forward-looking statements and other information contained herein concerning the oil and gas industry and the Corporation's general expectations concerning this industry are based on estimates prepared by management using data from publicly available industry sources as well as from reserve reports, market research and industry analysis and on assumptions based on data and knowledge of this industry which the Corporation believes to be reasonable. However, this data is inherently imprecise, although generally indicative of relative market positions, market shares and performance characteristics. While the Corporation is not aware of any misstatements regarding any industry data presented herein, the industry involves risks and uncertainties and is subject to change based on various factors.

DISCLOSURE CONTROLS AND PROCEDURES

Disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed is recorded, processed, summarized and reported with the time periods specified by securities regulations and that information required to be disclosed is accumulated and communicated to management.

The Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of the Corporation's disclosure controls and procedures as of December 31, 2007 and have concluded that they are adequate and effective to ensure accurate and complete disclosure.

DESIGN OF INTERNAL CONTROLS OVER FINANCIAL REPORTING

Effective for the year end 2006, securities regulations state that the Corporation is to design and implement internal controls over financial reporting and disclose in its MDandA any material changes in the Corporation's internal control over financial reporting that occurred during the Corporation's most recent interim period. Internal controls are processes designed and implemented by management to provide reasonable assurance regarding the reliability the Corporation's financial reporting and the preparation of financial statements and other financial information for external purposes in accordance with Canadian GAAP. For the year ended December 31, 2007, the Chief Executive Officer and the Chief Financial Officer have designed internal controls over financial reporting, or caused them to be designed under their supervision. Management has concluded that internal controls are adequately designed in this regard, considering the employees involved and the control procedures in place, including management and Audit Committee oversight. Occasionally, the Corporation requires outside assistance and advice on taxation, new accounting pronouncements and complex accounting and reporting issues, which is common with companies of a similar size. It should be noted, that the Corporation's control system, no matter how well designed, can provide only reasonable, but not absolute, assurance of detecting, preventing and deterring errors or fraud.

BUSINESS RISKS

Petro-Reef is exposed to risks inherent in the oil and gas industry. Operationally, the Corporation faces risks associated with finding, developing and producing oil and gas reserves, such as the availability of rigs and inclement weather. The Corporation continues to follow strict exploration criteria on each prospect to ensure high profitability and rate of return on capital investment. Exploration risks are managed by hiring skilled technical staff and by concentrating exploration activity on areas in which Petro-Reef has experience and expertise. Petro-Reef operates most of its production, allowing the Corporation to manage costs, timing and sales of production. Estimates of economically recoverable reserves and the future net cash flow are based on factors such as commodity prices, projected production and future capital and operating costs. These assumptions may differ from actual results. The Corporation has its reserves evaluated annually by an independent engineering firm. Petro-Reef is also exposed to environmental risks and risks associated with the reliance upon relationships with partners. Petro-Reef carries environmental liability, property, drilling and general liability insurance to mitigate its risks. The Corporation is also exposed to financial risks in the form of commodity prices, interest rates, the Canadian to U.S. dollar exchange rate and inflation. Petro-Reef manages commodity prices risks by focusing its capital program on areas that are expected to generate attractive rates of return.

ABBREVIATIONS

ARTC	Alberta Royalty Tax Credit	**GJs/d**	Gigajoules per day
bbl	barrel	**M3**	cubic meters
bbls	barrels	**Mbbls**	thousands of barrels
Bcf	billion cubic feet	**mcf**	thousand cubic feet
boe	barrel of oil equivalent (1 boe = 6 Mcf)	**mcf/d**	thousand cubic feet per day
		MMbbls	millions of barrels
bbls/d	Barrels per day	**mmcf**	million cubic feet
boe/d	Barrels of oil per day	**mmcf/d**	million cubic feet per day
FNR	Future net revenue	**NGLs**	natural gas liquids
GJ	Gigajoule	**NPV**	net present value

Reference is made to barrels of oil equivalent (BOE). Barrels of oil equivalent may be misleading, particularly if used in isolation. In accordance with National Instrument 51-101, a BOE conversion ratio for natural gas of 6 Mcf: 1 Bbl has been used, which is based on an energy equivalent conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

NOTE: In this report all currency values are in Canadian dollars.

Additional information about Petro-Reef is available on SEDAR at www.sedar.com.

SELECTED ANNUAL INFORMATION

FINANCIAL

Twelve months ended December 31	2007	2006	% Growth
Gross Revenue	$ 9,289,499	$ 7,156,594	29.8%
Cash Flow From Operations	$ 4,403,135	$ 3,557,432	23.8%
Earnings	$ (357,550)	$ 65,060	n/a
Weighted Average Shares – Basic	32,198,063	22,109,165	45.6%
Weighted Average Shares – Diluted	34,216,745	25,413,664	34.6%
Shares at Year End – Basic	33,714,781	23,685,291	42.3%

	Dec.31, 2007	Dec. 31, 2006	% Growth
Total Assets	$ 28,603,828	$ 15,056,446	90.0%
Long-term Financing	$ –	$ 375,000	(100.0%)

RESULTS OF OPERATIONS

PRODUCTION

Three months ended December 31	2007 Average	2006 Average	% Growth
Crude Oil and NGL (bbls/d)	37	53	(29.4%)
Natural Gas (mcf/d)	4,401	1,791	145.7%
Combined (boe/d)	771	351	119.4%

Twelve months ended December 31	2007 Average	2006 Average	% Growth
Crude Oil and NGL (bbls/d)	29	26	10.3%
Natural Gas (mcf/d)	3,591	2,568	39.8%
Combined (boe/d)	627	454	38.2%

FINANCIAL

Three months ended December 31	2007	2006	% Growth	2007 ($ / boe)	2006 ($ / boe)
Gross Revenue	$ 2,700,601	$ 1,461,644	84.8%	$ 38.09	$ 45.23
Royalties	743,345	262,928	182.7%	$ 10.48	$ 8.14
Revenue After Royalties	1,957,256	$ 1,198,716	63.3%	$ 27.61	$ 37.09
Operating Expenses	560,814	373,805	50.0%	$ 7.91	$ 11.57
Operating Netback	1,396,442	$ 824,911	69.3%	$ 19.70	$ 25.53
General and Administrative Expenses	650,788	209,713	210.3%	$ 9.18	$ 6.49
Interest Expense (Income)	(34,177)	11,189	n/a	$ (0.48)	$ 0.35
Non-cash Expenses	1,533,503	517,874	196.1%	$ 21.63	$ 16.03
Income Before Income Taxes recovery	(753,672)	$ 86,135	n/a	$ (10.63)	$ 2.67
Income Tax Expense	360,725	31,798	1,034.4%	$ (1.25)	$ 0.98
Net Income (Loss)	$ (665,086)	$ 54,337	n/a	$ (9.38)	$ 1.68
Per Share – Basic	$ (0.01)	$ 0.00			
Per Share - Diluted	$ (0.01)	$ 0.00			

Twelve months ended December 31	2007	2006	% Growth	2007 ($ / boe)	2006 ($ / boe)
Gross Revenue	$ 9,268,359	7,156,594	29.5%	$ 40.48	$ 43.18
Royalties	1,994,888	1,406,703	41.8%	$ 8.71	$ 8.49
Revenue After Royalties	7,273,471	$ 5,749,891	27.8%	$ 32.09	$ 34.70
Operating Expenses	1,797,471	1,502,968	19.6%	$ 7.85	$ 9.07
Operating Netback	5,476,000	$ 4,246,923	28.9%	$ 23.92	$ 25.63
General and Administrative Expenses	1,182,704	676,451	74.8%	$ 5.46	$ 4.08
Interest Expense (Income)	(176,735)	13,040	n/a	$ (0.77)	$ 0.08
Non-cash Expenses	4,579,249	3,284,687	39.4%	$ 20.00	$ 19.82
Income Before Income Taxes	$ (176,114)	$ 272,745	n/a	$ (0.77)	$ 1.65
Income Tax Expense	181,436	207,685	12.6%	$ (0.79)	$ 1.25
Net Income	$ (357,550)	$ 65,060	n/a	$ (1.56)	$ 0.39
Per Share – Basic	$ (0.01)	$ 0.00			
Per Share - Diluted	$ (0.01)	$ 0.00			

REVENUE

Three months ended December 31	2007	2006	% Growth	2007 ($ / boe)	2006 ($ / boe)
Gross Revenue	$ 2,700,601	$ 1,461,644	84.8%	$ 38.40	$ 45.23

Gross revenue increased 84.8% to $2,700,601 for the three month period ended December 31, 2007 compared to $1,461,644 for the same period ended December 31, 2006. Petro-Reef realized an all in price per unit of production for the three month period ended December 31, 2007 of $38.09, 15.8% lower than the realized price per unit of production of $45.23 per boe for the same period ended December 31, 2006.

Revenues increased as a result of a 119.4% increase in production year over year. The increase in production was sufficient to offset the 15.1%% decrease in realized commodity prices.

Three months ended December 31	2007	2006	% Growth	2007 ($ / boe)	2006 ($ / boe)
Gross Revenue	$ 9,268,359	$ 7,156,594	29.5%	$ 40.48	$ 43.18

Gross revenue increased 29.5% to $9,268,359 for the twelve month period ended December 31, 2007 compared to $7,156,594 for the same period ended December 31, 2006. Petro-Reef realized an all in price per unit of production for the twelve month period ended December 31, 2007 of $40.48, down 6.3% compared to the realized price per unit of production of $43.18 per boe for the same period ended December 31, 2006.

Below is a breakdown of gross revenue prices realized by Petro-Reef for the three and twelve month periods ended December 31, 2007:

Three months ended December 31	2007	2006	% Change
Crude Oil and NGL ($ / bbl)	$ 66.61	$ 24.26	174.6%
Natural Gas ($ / mcf)	$ 6.11	$ 8.09	(24.5%)

Twelve months ended December 31	2007	2006	% Change
Crude Oil and NGL ($ / bbl)	**$ 60.72**	$ 43.46	39.7%
Natural Gas ($ / mcf)	**$ 6.57**	$ 7.16	(8.2%)

ROYALTIES

Three months ended December 31	2007	2006	% Growth	2007 ($ / boe)	2006 ($ / boe)
Royalties	**$ 743,345**	$ 262,928	**182.7%**	**$ 10.48**	$ 8.14

Royalties increased 182.7% to $743,345 for the three month period ended December 31, 2007 compared to $262,928 for the same period ended December 31, 2006. Royalties on a per unit of production basis rose 28.9% to $10.48 for the three month period ended December 31, 2007 compared to $8.14 for the same period ended December 31, 2006. Royalties paid increased as a result of a 119.4% increase in production which resulted in an 86.3% increase in revenues during the quarter.

The effective royalty rate rose to 27.3% for the three month period ended December 31, 2007 from 18.0% for the same period ended December 31, 2006. This increase in the effective royalty rate was a result of an increase in production from lands which pay Crown royalties as well as a $168,000 adjustment relating to Freehold Mineral Taxes which were all booked in the fourth quarter.

Twelve months ended December 31	2007	2006	% Growth	2007 ($ / boe)	2006 ($ / boe)
Royalties	**$ 1,994,888**	$ 1,406,703	**41.8%**	**$ 8.71**	$ 8.49

Royalties increased 41.8% to $1,994,888 for the twelve month period ended December 31, 2007 compared to $1,406,703 for the same period ended December 31, 2006. Royalties on a per unit of production basis increased slightly to $8.71 for the Twelve month period ended December 31, 2007 and December 31, 2006.

The effective royalty rate rose to 21.5% for the twelve month period ended December 31, 2007 from 19.7% for the same period ended December 31, 2006. Royalty rates for the twelve month period ended December 31, 2007 were higher as a result of increased production volumes being produced on Crown land. For the 12-month period ended December 31, 2007, approximately 45% of royalties were paid to the Crown, with the balance being paid to Freehold and other mineral rights owners.

OPERATING EXPENSES

Three months ended December 31	2007	2006	% Growth	2007 ($ / boe)	2006 ($ / boe)
Operating Expenses	**$ 560,814**	$ 373,805	**50.0%**	**$ 7.91**	$ 11.57

Operating Expenses rose 50.0% to $560,814 the three month period ended December 31, 2007 compared to $373,805 for the same period ended December 31, 2006. Production expenses on a per unit of production basis fell 31.6% to $7.91 for the three month period ended December 31, 2007 compared to $11.57 for the same period ended December 31, 2006.

Operating expenses rose 50% as a result of a 119.4% increase in production year over year. Operating expenses on a per unit of production basis fell 31.6% as a result of higher production volumes and the operational synergies realized from the centralization of processing facilities at the Corporation's 8-1 facility in Alexander Qui-Barre. Operating costs during the fourth quarter included prior period and 13th month adjustments which were required to reconcile estimated and actual operating costs during the year. Operating costs excluding prior period adjustments was approximately $460,000, or approximately $6.61 per unit of production. Petro-Reef expects operating costs on a per unit of production basis to continue to fall in subsequent quarters as increased production results in higher utilization of Petro-Reef's pipelines and facilities resulting in increased operational efficiencies.

Twelve months ended December 31	2007	2006	% Growth	2007 ($ / boe)	2006 ($ / boe)
Operating Expenses	**$ 1,797,471**	$ 1,502,968	**19.6%**	**$ 7.85**	$ 9.07

Operating expenses increased 19.6% to $1,797,471 for the twelve month period ended December 31, 2007 compared to $1,502,968 for the same period ended December 31, 2006. Operating expenses on a per unit of production basis fell 13.4% to $7.85 for the twelve month period ended December 31, 2007 compared to $9.07 for the same period ended December 31, 2006.

GENERAL AND ADMINISTRATIVE EXPENSES

Three months ended December 31	2007	2006	% Growth	2007 ($ / boe)	2006 ($ / boe)
General and Administrative Expenses	**$ 650,788**	$ 209,713	**210.3%**	**$ 9.18**	$ 6.49

General and administrative expenses rose 210.3% to $650,788 for the three month period ended December 31, 2007 compared to $209,713 for the same period ended December 31, 2006. General and administrative expenses on a per unit of production basis rose 41.4% to $9.18 for the three month period ended December 31, 2007 compared to $6.49 for the same period ended December 31, 2006.

During the fourth quarter, Petro-Reef paid approximately $350,000 in severance relating to the buy-out of a management contract relating to the departure of a senior member of the Corporation's staff. With the aforementioned payments, all obligations relating to this severance package were met. Also included in the Q4 – 2007 financials is approximately $100,000 in fees relating to year-end audit and engineering report expenditures. Excluding the one-time, non-recurring severance and the fees relating to the year-end audit and engineering report, Petro-Reef's general and administrative expenses would have been approximately $200,000, which would have represented a 4.6% decrease in aggregate general and administrative expenses. Excluding the severance package and year end expenditures, general and administrative expenses on a per unit of production basis would have fallen to $2.82, representing a 56.5% decrease year over year. Petro-Reef expects future general and administrative costs on a per unit of production basis to be consistent with the revised general and administrative number as the severance amount was a one-time item and the year end expenditures will be accrued throughout the year in 2008.

Twelve months ended December 31	2007	2006	% Growth	2007 ($ / boe)	2006 ($ / boe)
General and Administrative Expenses	**$ 1,249,600**	$ 676,451	**84.7%**	**$ 5.46**	$ 4.08

General and administrative expenses rose 84.7% % to $1,249,600 for the twelve month period ended December 31, 2007 compared to $676,451 for the same period ended December 31, 2006. General and administrative expenses on a per unit of production basis rose 33.7% to $5.46 for the twelve month period ended December 31, 2007 compared to $4.08 for the same period ended December 31, 2006.

NET INTEREST EXPENSE (INCOME)

Three months ended December 31		2007		2006	% Growth		2007 ($ / boe)		2006 ($ / boe)
Net Interest Expenses (Income)	$	(34,177)	$	11,189	n/a		($0.48)	$	0.35

Petro-Reef earned net interest income of $34,177 for the three month period ended December 31, 2007 compared to interest expense of $11,189 for the same period ended December 31, 2006. Net interest income on a per unit of production basis was $0.48, compared to an interest expense of $0.35 per unit of production in 2006. Petro-Reef Resources Ltd. had cash and short-term investments of $4,921,309 as at December 31, 2007 with $0 in bank debt. Petro-Reef invests all short-term investments in investment grade banker's acceptance and money market funds. As a result, Petro-Reef Resources has no exposure to asset backed commercial paper.

Twelve months ended December 31		2007		2006	% Growth		2007 ($ / boe)		2006 ($ / boe)
Net Interest Expenses (Income)	$	(176,735)	$	13,040	n/a	$	(0.77)	$	0.08

Petro-Reef earned net interest income of $176,735 for the twelve month period ended December 31, 2007 compared to interest expense $13,040 for the same period ended December 31, 2006. On a per unit of production basis, the Corporation earned $0.77 compared to a net interest expense of $0.08 for 2006.

NON CASH EXPENSES

Three months ended December 31		2007		2006	% Growth		2007 ($ / boe)		2006 ($ / boe)
Depletion and Amortization	$	1,220,731	$	316,464	285.7%	$	17.22	$	9.79
Accretion Expense		4,388		20,289	(78.4%)	$	0.06	$	0.63
Stock-Based Compensation		308,384		181,121	70.3%	$	4.35	$	5.60
Total Non Cash Items	$	1,533,503	$	517,874	196.1%	$	21.63	$	16.03

Non cash expenses rose 196.1% to $1,533,503 for the three month period ended December 31, 2007 compared to $517,874 for the same period ended December 31, 2006. On a per unit of production basis, non cash expenses increased 35.0% to $21.63 for the three month period ended December 31, 2007 compared to $16.03 for the same period ended December 31, 2006.

Depletion and amortization expense increased 285.7% to $1,220,731 as a result of a significant increase in production year over year. The increase in production combined with an increase in capital expenditures in 2007 resulted in higher depletion on an aggregate basis.

Stock-based compensation rose 125.9% as a result of the issuance of 1,580,000 stock options during the twelve month period ended December 31, 2007. Stock options are issued with a 12-month vesting period. As a result, the expenses related to stock options granted are amortized over the 12-month period. The increase in stock options granted in 2007 resulted in a higher stock-based compensation being incurred by the Corporation.

Twelve months ended December 31	2007	2006	% Growth	2007 ($ / boe)	2006 ($ / boe)
Depletion and Amortization	$ 3,323,466	$ 2,770,624	20.0%	$ 14.52	$ 16.72
Accretion Expense	19,484	31,786	(38.7%)	$ 0.09	$ 0.19
Stock Based Compensation	1,236,299	481,709	156.6%	$ 5.40	$ 2.91
Loss on Settlement of Asset Retirement Obligation	–	568	(100.0%)	–	$ 0.00
Total Non Cash Items	$ 4,579,249	$ 3,284,684	39.4%	$ 20.00	$ 19.82

Non cash expenses rose 39.4%% to $4,579,249 for the twelve month period ended December 31, 2007 compared to $3,284,684 for the same period ended December 31, 2006. On a per unit of production basis, non cash expenses increased 0.9% to $20.00 for the twelve month period ended December 31, 2007 compared to $19.82 for the same period ended December 31, 2006.

INCOME TAXES

Three months ended December 31	2007	2006	% Growth	2007 ($ / boe)	2006 ($ / boe)
Current Tax	$ –	$ –	n/a	$ 0.00	$0.00
Future Tax	(88.664)	31,798	n/a	$ (1.25)	$ 0.98
Total Income Taxes	$ (88.664)	$ 31,798	n/a	$ (1.25)	$ 0.98

Income taxes fell to $181,436 for the twelve month period ended December 31, 2007 compared to an income tax expense of $207,685 for the same period ended December 31, 2006. On a per unit of production basis, income taxes fell to $0.79 for the twelve month period ended December 31, 2007 compared to an expense of $1.25 for the same period ended December 31, 2006.

Twelve months ended December 31	2007	2006	% Growth	2007 ($ / boe)	2006 ($ / boe)
Current Tax	$ –	$ –	n/a	$ 0.00	$ 0.00
Future Tax	630,826	207,685	203.7%	$ 2.76	$ 1.25
Total Income Taxes	$ 630,826	$ 207,685	203.7%	$ 2.76	$ 1.25

Income taxes increased to $630,826 for the twelve month period ended December 31, 2007 compared to an income tax expense of $207,685 for the same period ended December 31, 2006. On a per unit of production basis, income taxes increased to $2.76 for the twelve month period ended December 31, 2007 compared to an expense of $1.25 for the same period ended December 31, 2006.

LIQUIDITY AND FINANCIAL CONDITION

Twelve months ended December 31	2007	2006
Working Capital	$ (120,357)	$ (4,225,810)
Oil and Gas Properties	$ 20,682,771	$ 13,171,164

Petro-Reef's working capital deficit at December 31, 2007 was $120,357 compared to a deficit of $4,225,810 at December 31, 2006. The working capital position improved as a result of the issuance of $3,000,000 in flow-through shares in April 2007, $6,000,000 by way of a private placement financing in January 2007 and the exercise of warrants in February 2007 raising proceeds of approximately $2,500,000. As at December 31, 2007, Petro-Reef Resources had cash and short-term investment holdings of $4,921,309.

Petro-Reef's bank credit facility is structured as a $7,750,000 revolving operating demand loan and a $2,250,000 non-revolving acquisition / development demand loan. As at December 31, 2007, Petro-Reef Resources Ltd. was in compliance with all of its bank covenants. Petro-Reef had no bank debt outstanding as at December 31, 2007.

Based on current cash holdings, forecast cash flows from operations and available bank credit financing, Petro-Reef is confident in its ability to fund ongoing capital and operating expenditures.

Capitalized resource properties as at December 31, 2007 were $20,713,169 net of accumulated depletion, compared to $13,174,164 as at December 31, 2006. Oil and gas properties increased as a result of continued developments of oil and gas properties, the construction of infrastructure and the acquisition of undeveloped land. For the three and twelve month periods ended December 31, 2007 Petro-Reef incurred $3,210,696 and $10,789,207 respectively in net capital expenditures.

CASH FLOW FROM OPERATIONS

For the three month period ended December 31, 2007, Petro-Reef generated cash flows from operations of $779,831 ($0.02 per basic/diluted share), an increase of 29.1% compared to $604,009 ($0.03 per basic/diluted share) for the three month period ended December 31, 2006. For the twelve month period ended December 31, 2007 the Corporation generated cash flows from operations of $4,403,135 ($0.13 per basic/diluted share), a 23.7 % increase compared to $3,557,432 ($0.16 per basic/diluted share) for the twelve month period ended December 31, 2006.

Cash flow from operations, representing cash generated from operating activities before changes in non-cash working capital items, is a non-GAAP measure. Management utilizes cash flow as a key measure to assess the ability of the Corporation to finance operating activities and capital expenditures. In addition, cash flow has been described and presented in order to provide shareholders and potential investors with information regarding the Corporation's liquidity and its ability to generate funds to finance its operations. This performance indicator may not be comparable to similar measures used by other companies.

Three months ended December 31	2007	2006
Net Income (Loss) For The Period	$ (619,107)	$ 54,337
Future Income Tax Provision	(134,566)	31,798
Accretion Expense	4,388	20,289
Stock-Based Compensation	308,384	181,121
Depletion And Amortization	1,220,731	316,464
Cash Flow From Operations	$ 779,831	$ 604,009

Twelve months ended December 31	2007	2006
Net Income For The Period	$ (357,550)	$ 65,060
Future Income Tax Provision	181,436	207,685
Accretion Expense	19,484	31,786
Loss on Settlement of Asset Retirement Obligation	–	568
Stock-Based Compensation	1,236,299	481,709
Depletion And Amortization	3,323,465	2,770,624
Cash Flow From Operations	$ 403,135	$ 3,557,432

CAPITAL RESOURCES

The Corporation's share capital is as follows:

	December 31, 2007		December 31, 2006	
	No. of Shares	Amounts	No. of Shares	Amounts
Common Shares	33,714,781	$ 17,181,982	23,685,291	$ 7,559,760

In the first quarter of 2007, the Corporation issued 5,260,870 units priced at $1.15 per unit. Each unit consisted of one common share and one half of a common share purchase warrant. During the second quarter of 2007 the Corporation issued 1,500,000 flow-through shares priced at $2.00. In the first half of 2007, 3,824,987 warrants were exercised generating gross proceeds of $2,495,758. During the fourth quarter, 140,000 stock options were exercised by a director of the Corporation.

COMMITMENTS AND CONTINGENCIES

Petro-Reef has met its flow-through obligations relating to its equity issue in April 2007. The Corporation was required to incur exploration and development activities by December 31, 2008 of $3,000,000 as a result of flow-through shares issued in April 2007. As an incentive for junior oil and gas companies, the Canadian Tax Act allows $1,000,000 of eligible Canadian development expenses to be reclassified as Canadian exploration expenses which ultimately reduces the exploration commitment associated with the Corporations flow-through share equity issue. As a result, Petro-Reef had to incur $2,000,000 of eligible Canadian exploration expenses and $1,000,000 of eligible Canadian development expenses by December 31, 2008. As at December 31, 2007, the Corporation has incurred qualifying exploration expenditures of approximately $3,432,002 and $2,268,780 of eligible development expenditures.

OFF-BALANCE SHEET ARRANGEMENTS

The Corporation does not have any off-balance sheet arrangements.

OUTLOOK

Petro-Reef entered 2008 in a strong financial position. The combination of production increases in late 2007, a strong balance sheet and increasing commodity prices has laid the foundation for continued growth.

In February 2008, Petro-Reef announced the acquisition of a working interest partner in the Corporation's core area of Alexander Qui-Barre, Alberta. Petro-Reef acquired approximately 400 boe/d of production, increased working interest in over 25 sections of undeveloped land in Alexander Qui-Barre and an additional 10% working interest in the Petro-Reef operated Alexander Qui-Barre natural gas processing facility. The acquisition cost the Corporation $10,400,000, before adjustments and was financed through a new credit facility provided by the National Bank of Canada and from cash available on the Corporation's balance sheet.

RELATED PARTY TRANSACTIONS

All related party transactions are in the normal course of operations and have been measured at the agreed to exchange amounts, which is the amount of consideration established and agreed to by the related parties. During the year, the Corporation purchased engineering services in the amount of $1,505,542 (2006 - $1,051,073) from a company controlled by a Director of the Corporation. The Corporation also purchased professional services in the amount of $220,367 (2006 - $78,086) from a law firm which a Director of the Corporation is a partner of.

ACCOUNTING POLICIES

Petro-Reef Resources Ltd. (the "Corporation") is engaged in the exploration for and production of oil and natural gas in Canada. The financial statements of the Corporation have been prepared in accordance with accounting principles generally accepted in Canada.

The Corporation has a working capital deficit of $120,357 as at December 31, 2007 compared to a working capital deficit of $4,225,810 as at December 31, 2006. The Corporation is subject to certain debt covenants pertaining to demand operating facilities (Note 3). At December 31, 2007 the Corporation was in compliance with all covenants.

Significant accounting policies are summarized as follows:

OIL AND GAS OPERATIONS

The Company follows the full cost method of accounting for crude oil and gas operations whereby all costs related to the acquisition of, exploration for and development of oil and gas reserves are capitalized. Such costs include leasehold acquisition costs, geological and geophysical costs, lease rentals, drilling, plant and equipment costs and related overhead. Government incentives are credited to the cost of the oil and gas properties at the time the expenditures are incurred. Proceeds from the disposal of properties are applied as a reduction of the cost of the remaining assets with no gain or loss recognized, unless such a sale would result in a change of more than twenty percent depletion rate.

The Company places a limit on the carrying value of property, plant and equipment and other assets, which may be depleted against revenues of future periods (the "ceiling test"). The carrying value is assessed to be recoverable when the sum of the undiscounted cash flows expected from the production of proved reserves using forward pricing, the lower of cost and market of unproved properties and the cost of major development projects exceeds the carrying value. When the carrying value is not assessed to be recoverable, an impairment loss is recognized to the extent that the carrying value of assets exceeds the fair value of proved and probable reserves, and the cost, less any impairment, of unproved properties that contain no probable reserves.

Depletion is computed using the unit-of-production method based on gross estimated proved oil and gas reserves (converted to equivalent units on the basis of estimated relative energy content). In determining the appropriate depletion rate, the Company includes the net book value of its oil and gas properties, as well as the estimated future costs to be incurred in developing proved reserves and excludes the unimpaired cost attributable to unproved properties.

DEPRECIATION

Depreciation of furniture and fixtures is calculated using the declining balance method at an annual rate of 20%. Depreciation of computer equipment is calculated using the declining balance method at an annual rate of 45%. Leasehold improvements are amortized over the useful life of 5 years using the straight-line method.

ASSET RETIREMENT OBLIGATION

The Company records a liability for the fair value of legal obligations associated with the retirement of long lived tangible assets in the period in which they are incurred, normally when the asset is purchased or developed. On recognition of the liability there is a corresponding increase in the carrying amount of the related asset known as the asset retirement cost, which is depleted on a unit-of-production basis over the life of the reserves. The liability is adjusted each reporting period to reflect the passage of time, with the accretion charged to earnings, and for revisions to the estimated future cash flows. Actual costs incurred upon settlement of the obligations are charged against the liability.

STOCK OPTIONS

The Company has an incentive stock option plan for employees, officers, directors and consultants as described in note 6. The Company records stock based compensation expense using the fair value method. The fair value of an option is calculated at the grant date, and expensed equally over the vesting term of the option. The Company records the cumulative stock based compensation as a contributed surplus. When options are exercised, contributed surplus is reduced and share capital is increased by the amount of accumulated stock based compensation for the exercised option. Any consideration received on the exercise of stock options is credited to share capital.

REVENUE RECOGNITION

Revenue associated with the sale of crude oil, natural gas and natural gas liquids owned by the company are recognized when title passes from the company to its customers.

INCOME TAXES

The company follows the liability method of accounting for income taxes. Under this method, the company records future income taxes for the effect of any differences between the accounting and the income tax basis of an asset or liability using income tax rates substantially enacted on the balance sheet date. The effect of a change in income tax rates on the future income tax assets and liabilities is recognized as income in the period of the change.

EARNINGS PER SHARE

The company uses the treasury stock method to determine the dilutive effect of stock options and other dilutive instruments. This method assumes that any proceeds from the exercise of in-the-money stock options or other dilutive instruments are assumed to be used to purchase common shares at the average market price during the period.

JOINT VENTURES

Substantially all of the company's activities are conducted jointly with other industry partners and accordingly, these financial statements reflect only the company's proportionate interest in such activities.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of all cash on hand and balances with banks, as well as all highly liquid short-term investments. The Company considers all highly liquid short-term investments with original terms to maturity of three months or less to be cash equivalents.

FLOW THROUGH SHARE ISSUANCE

The Corporation finances a portion of its exploration program through the issuance of flow-through shares. Under the terms of the flow-through share agreements, and as provided for under the Income Tax Act, the tax attributes of qualifying exploration costs incurred by the Corporation are renounced to subscribers. To recognize the foregone tax benefits to the Corporation, the amount for which the shares are issued is reduced by the tax effect of the tax benefits renounced to subscribers at the time the renunciation documents are filed with the tax authorities.

MEASUREMENT UNCERTAINTY

The preparation of consolidated financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions and to use judgment regarding assets, liabilities, revenues and expenses. Accordingly, actual results may differ from those estimated amounts.

Recorded amounts for depletion and depreciation, asset retirement obligations and abandonment costs, the impairment of oil and natural gas properties and amounts used for the ceiling test and impairment calculations and based on estimates of oil and natural gas reserves and future costs required to develop those reserves. By their nature, these estimates of reserves and the related future cash flows and costs are subject to measurement uncertainty, and the effect on the consolidated financial statements of future periods could be significant.

NEW ADOPTED ACCOUNTING STANDARDS

Effective January 1, 2007, the Company adopted the following new Canadian Institute of Chartered Accountants ("CICA") Handbook sections:

a. Section 1530, Comprehensive Income;

b. Section 3251, Equity;

c. Section 3855, Financial Instruments – Recognition and Measurement; and

d. Section 3865, Hedges

These new accounting standards provide requirements for the recognition and measurement of financial instruments and the use of hedge accounting. The standards have been adopted prospectively and, therefore, the prior periods have not been restated. Comprehensive income CICA Handbook Section 1530 establishes standards for reporting and presenting comprehensive income and other comprehensive income. Comprehensive income is defined as the change in equity from transactions and other events from non-owner sources and other comprehensive income, which is comprised of gains and losses that are recognized in comprehensive income but excluded from net earnings.

The Company also adopted Section 3251 – Equity which establishes standards for the presentation of equity and changes in equity during the reporting period, effective for fiscal years beginning January 1, 2007.

Financial instruments and derivatives CICA Handbook Section 3855 prescribes when a financial asset, financial liability or non-financial derivative is to be recognized on the balance sheet and at what amount, requiring fair-value or cost-based measures under different circumstances. All financial instruments must be classified as one of the following five categories: loans and receivables, held-to-maturity investments; held-for-trading instruments; available -for-sale financial assets; or other financial liabilities. All financial instruments, with the exception of loans and receivables, held-to-maturity investments and other financial liabilities are reported on the balance sheet date at fair value.

Subsequent measurement and changes in fair value will depend on their initial classification. Available -for-sale financial assets are measured at fair value and unrealized gains or losses resulting from changes in fair value are recorded in other comprehensive income until the investment is de-recognized or impaired, at which time the amounts would be recognized as earnings.

Hedges CICA Handbook Section 3865 provides alternative treatments to Section 3855 for entities which choose to designate qualifying transactions as hedges for accounting purposes. It replaces and expands on Accounting Guideline 13 "Hedging Relationships" and the hedging guidance in section 1650 "Foreign Currency Translation" by specifying how hedge accounting is applied and what disclosures are necessary when it is applied.

The application of all of the aforementioned handbook sections did not have an impact on the Corporation's financial statements.

SHARE PURCHASE WARRANTS

The Corporation estimated the fair value of share purchase warrants that were issued. Fair value is estimated using the Black-Scholes method. When exercised the fair value is added to share capital to represent the cost to the Company of issuing the warrants.

NEW ACCOUNTING PRONOUNCEMENTS

Effective January 1, 2008, the Corporation will be required to adopt the CICA Handbook Section 1506 - Accounting Changes that provides expanded disclosures for changes in accounting policies, accounting estimates and corrections of errors. Under the new standard, accounting changes should be applied retroactively unless otherwise permitted or where the effect is impracticable to determine. As well, voluntary changes in accounting policy are made only when required by a primary source of GAAP or the change results in more relevant and reliable information.

As of January 1, 2008, the Corporation will be required to adopt two new CICA standards, Section 3862 – Financial Instruments – Disclosures, and Section 3863 – Financial Instruments – Presentation, which will replace Section 3861 – Financial Instruments – Disclosure and Presentation. The new disclosure standard increases the emphasis on the risks associated with both recognized and unrecognized financial instruments and how those risks are managed. The new presentation standard carries forward the former presentation requirements.

As of January 1, 2008, the Corporation will be required to adopt CICA Handbook Section 1535 – Capital Disclosures, which requires entities to disclose objectives, policies and processes for managing capital, and in addition, whether the entity has complied with any externally imposed capital requirements. The Company is assessing the impact of this new standard on its financial statements and anticipates that the main impact will be in terms of additional disclosures required.

Significant accounting policies are summarized as follows:

SELECTED QUARTERLY INFORMATION

	2007			
	Q4	**Q3**	**Q2**	**Q1**
Revenue	**$ 1,957,256**	**$ 1,795,473**	**$ 2,228,590**	**$ 2,543,695**
Cash flow	**$ 779,831**	**$ 951,444**	**$ 1,104,425**	**$ 1,567,436**
Net Income (Loss)	**$ (665,008)**	**(199,246)**	**$ 62,025**	**$ 444,680**
Net Income (Loss) Per Share	**$ (0.02)**	**$ (0.01)**	**$ 0.00**	**$ 0.01**
Capital Expenditures	**$ 3,126,358**	**$ 2,960,159**	**$ 2,190,597**	**$ 2,427,755**
Total Assets	**$ 28,603,828**	**$ 26,488,367**	**$ 26,691,045**	**$ 25,712,699**
Shareholders Equity	**$ 19,483,847**	**$ 19,473,249**	**$ 19,347,503**	**$ 16,168,187**
Avg. Daily Production (boe/d)	**771**	**595**	**544**	**594**

	2006			
	Q4	Q3	Q2	Q1
Revenue	$ 1,456,725	$ 1,190,883	$ 1,937,954	$ 2,566,850
Cash flow	$ 604,010	$ 590,330	$ 1,111,085	$ 1,252,007
Net Income (Loss)	$ 54,337	$ (67,349)	$ 2,619	$ 75,453
Net Income (Loss) per share	$ 0.00	$ (0.00)	$ 0.00	$ 0.00
Capital Expenditures	$ 2,694,363	$ 2,478,043	$ 2,218,013	$ 497,869
Total Assets	$ 15,056,446	$ 13,565,661	$ 12,103,363	$ 10,316,473
Shareholders Equity	$ 7,919,194	$ 7,003,587	$ 6,600,111	$ 6,103,921
Avg. Daily Production (boe/d)	354	338	534	593

Note:

(1) Net income (loss) adjusted in Q1, Q2, Q3 2007 as a result of restated stock based compensation expense resulting from amended volatility assumptions utilized in calculations

AUDITORS' REPORT

April 24, 2008

TO THE SHAREHOLDERS OF PETRO-REEF RESOURCES LTD.

We have audited the balance sheets of Petro-Reef Resources Ltd. as at December 31, 2007 and 2006 and the statements of operations, comprehensive income (loss) and deficit and cash flows for the years then ended. These consolidated financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants
Calgary, Alberta

BALANCE SHEET

AS AT DECEMBER 31, 2007 AND DECEMBER 31, 2006

Audited

ASSETS	2007	2006
Cash and Cash Equivalents	$ 4,921,309	$ –
Accounts receivable	2,833,229	1,864,015
Prepaid expenses and deposits	166,519	21,267
	7,921,057	1,885,282
Property, plant and equipment (note 2)	20,682,771	13,171,164
	$ 28,603,828	$ 15,056,446
LIABILITIES		
Current liabilities		
Cheques drawn in excess of bank	$ –	$ 1,613
Bank line of credit (note 3)	–	375,000
Accounts payable and accrued charges	8,041,414	5,734,479
	8,041,414	6,111,092
Future income taxes (note 7)	538,727	634,512
Asset retirement obligation (note 4)	539,840	391,648
	9,119,981	7,137,252
SHAREHOLDERS' EQUITY		
Share capital (note 5)	17,946,983	7,559,760
Warrants (note 5)	840,429	606,719
Broker warrants (note 5)	212,685	–
Contributed surplus (note 5)	1,659,194	570,609
Cumulative Deficit	(1,175,444)	(817,894)
	19,483,847	7,919,194
	$ 28,603,828	$ 15,056,446

Commitments (note 5)

See accompanying notes to the financial statements

J Werner

Joseph Werner
Director

H. A. Sebo

Huba A. Sebo
Director

STATEMENT OF OPERATIONS, COMPREHENSIVE INCOME (LOSS) AND DEFICIT

FOR THE YEARS ENDED DECEMBER 31, 2007 AND DECEMBER 31, 2006

REVENUE	2007	2006
Total Revenue, net of royalties and ARTC	**$ 7,273,471**	$ 5,749,891
Expenses		
Production expenses	**$ 1,797,471**	$ 1,502,968
Accretion expense (note 4)	**19,484**	31,786
Depletion and depreciation	**3,323,466**	2,770,624
Stock-based compensation (note 6)	**1,236,299**	481,709
General and administrative	**1,249,600**	676,451
Net interest expense (income)	**(176,735)**	13,040
Loss on settlement of asset retirement obligation	**–**	568
	7,449,585	5,477,146
Earnings before taxes	**(176,114)**	272,745
Future income tax (note 7)	**181,436**	207,685
NET INCOME (LOSS) AND COMPREHENSIVE		
Income (loss) for the year	**$ (357,550)**	$ 65,060
Deficit – Beginning of year	**$ (817,894)**	$ (882,954)
Deficit – End of year	**$ (1,175,444)**	$ (817,894)
Basic and diluted income per common share	**$ (0.01)**	$ 0.00

See accompanying notes to the financial statements

STATEMENT OF CASH FLOW

FOR THE YEARS ENDED DECEMBER 31, 2007 AND DECEMBER 31 2006

Audited

CASH PROVIDED BY (USED IN)	**2007**	2006
Operating activities		
Net income (loss) for the year	**$ (357,550)**	$ 65,060
Items not effecting working capital		
Accretion expense	**19,484**	31,786
Depletion and depreciation	**3,323,466**	2,770,624
Loss on settlement of asset retirement obligation	**–**	568
Stock-based compensation	**1,236,299**	481,709
Future income taxes	**181,436**	207,685
Cash flow from operations	**4,403,135**	3,557,432
Asset retirement obligations	**–**	(1,000)
Net change in non-cash operating working capital items	**1,244,143**	1,585,925
	5,647,278	5,142,357
Financing activities		
Bank line of credit	**(376,613)**	375,000
Proceeds from share issue	**9,050,000**	–
Share issue costs	**(827,233)**	(1,500)
Proceeds from exercise of stock options and warrants	**2,186,034**	1,343,957
	10,032,188	1,717,457
Investing activities		
Expenditures on property, plant and equipment	**(10,704,869)**	(7,888,288)
Net change in non-cash investing working capital items	**(51,675)**	628,957
	(10,756,544)	(7,259,331)
Change in cash during the year	**$ 4,922,922**	(399,517)
Cash and cash equivalents - Beginning of year	**$ (1,613)**	$ 397,904
Cash and cash equivalents, End of year	**$ 4,921,309**	$ (1,613)

See accompanying notes to the financial statements

STATEMENT OF OPERATIONS, OTHER INCOME AND DEFICIT

FOR THE THREE MONTHS AND TWELVE MONTHS ENDED DECEMBER 31, 2007 AND DECEMBER 31 2006

Audited

REVENUE	**3-months Ended December 31, 2007**	3-months Ended December 31, 2006	**12-months Ended December 31, 2007**	12-months Ended December 31, 2006
Oil and gas sales, net of royalties and ARTC	**$ 2,029,652**	$ 1,198,716	**$ 7,345,868**	$ 5,749,891
Expenses				
Production expenses	**$ 560,814**	$ 373,805	**$ 1,797,471**	$ 1,502,968
Accretion expense	**4,388**	20,289	**19,484**	31,786
Depletion and depreciation	**1,220,731**	316,464	**3,323,465**	2,770,624
Stock-based compensation	**409,102**	181,121	**1,468,646**	481,709
General and administrative	**583,892**	209,713	**1,182,704**	676,451
Net Interest expense (income)	**(34,177)**	11,189	**(176,735)**	13,040
Loss on settlement of asset retirement obligation	**–**	–	**–**	568
	2,744,750	1,112,581	**7,615,036**	5,477,146
Earnings before taxes	**(715,098)**	86,135	**(269,168)**	272,745
Future income tax	**360,725**	31,798	**630,826**	207,685
Net income (loss) for the period	**$ (1,075,823)**	$ 54,337	**$ (899,993)**	$ 65,060
Deficit – Beginning of period	**$ (642,064)**	$ (872,231)	**$ (817,894)**	$ (882,954)
Deficit – End of period	**$ (1,717,887)**	$ (817,894)	**$ (1,717,887)**	$ (817,891)
Basic and diluted income per common share	**$ (0.03)**	$ 0.00	**$ (0.03)**	$ 0.00

See accompanying notes to the financial statements

NOTES TO FINANCIAL STATEMENTS

The Corporation has a working capital deficit of $120,357 as at December 31, 2007 compared to a working capital deficit of $4,225,810 as at December 31, 2006. The Corporation is subject to certain debt covenants pertaining to demand operating facilities (Note 3). At December 31, 2007 the Corporation was in compliance with all covenants.

Significant accounting policies are summarized as follows:

OIL AND GAS OPERATIONS

The Company follows the full cost method of accounting for crude oil and gas operations whereby all costs related to the acquisition of, exploration for and development of oil and gas reserves are capitalized. Such costs include leasehold acquisition costs, geological and geophysical costs, lease rentals, drilling, plant and equipment costs and related overhead. Government incentives are credited to the cost of the oil and gas properties at the time the expenditures are incurred. Proceeds from the disposal of properties are applied as a reduction of the cost of the remaining assets with no gain or loss recognized, unless such a sale would result in a change of more than twenty percent depletion rate.

The Company places a limit on the carrying value of property, plant and equipment and other assets, which may be depleted against revenues of future periods (the "ceiling test"). The carrying value is assessed to be recoverable when the sum of the undiscounted cash flows expected from the production of proved reserves using forward pricing, the lower of cost and market of unproved properties and the cost of major development projects exceeds the carrying value. When the carrying value is not assessed to be recoverable, an impairment loss is recognized to the extent that the carrying value of assets exceeds the fair value of proved and probable reserves, and the cost, less any impairment, of unproved properties that contain no probable reserves.

Depletion is computed using the unit-of-production method based on gross estimated proved oil and gas reserves (converted to equivalent units on the basis of estimated relative energy content). In determining the appropriate depletion rate, the Company includes the net book value of its oil and gas properties, as well as the estimated future costs to be incurred in developing proved reserves and excludes the unimpaired cost attributable to unproved properties.

DEPRECIATION

Depreciation of furniture and fixtures is calculated using the declining balance method at an annual rate of 20%. Depreciation of computer equipment is calculated using the declining balance method at an annual rate of 45%. Leasehold improvements are amortized over the useful life of 5 years using the straight-line method.

ASSET RETIREMENT OBLIGATION

The Company records a liability for the fair value of legal obligations associated with the retirement of long lived tangible assets in the period in which they are incurred, normally when the asset is purchased or developed. On recognition of the liability there is a corresponding increase in the carrying amount of the related asset known as the asset retirement cost, which is depleted on a unit-of-production basis over the life of the reserves. The liability is adjusted each reporting period to reflect the passage of time, with the accretion charged to earnings, and for revisions to the estimated future cash flows. Actual costs incurred upon settlement of the obligations are charged against the liability.

STOCK OPTIONS

The Company has an incentive stock option plan for employees, officers, directors and consultants as described in note 6. The Company records stock based compensation expense using the fair value method. The fair value of an option is calculated at the grant date, and expensed equally over the vesting term of the option. The Company records the cumulative stock based compensation as a contributed surplus. When options are exercised, contributed surplus

is reduced and share capital is increased by the amount of accumulated stock based compensation for the exercised option. Any consideration received on the exercise of stock options is credited to share capital.

REVENUE RECOGNITION

Revenue associated with the sale of crude oil, natural gas and natural gas liquids owned by the company are recognized when title passes from the company to its customers.

INCOME TAXES

The company follows the liability method of accounting for income taxes. Under this method, the company records future income taxes for the effect of any differences between the accounting and the income tax basis of an asset or liability using income tax rates substantially enacted on the balance sheet date. The effect of a change in income tax rates on the future income tax assets and liabilities is recognized as income in the period of the change.

EARNINGS PER SHARE

The company uses the treasury stock method to determine the dilutive effect of stock options and other dilutive instruments. This method assumes that any proceeds from the exercise of in-the-money stock options or other dilutive instruments are assumed to be used to purchase common shares at the average market price during the period.

JOINT VENTURES

Substantially all of the company's activities are conducted jointly with other industry partners and accordingly, these financial statements reflect only the company's proportionate interest in such activities.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of all cash on hand and balances with banks, as well as all highly liquid short-term investments. The Company considers all highly liquid short-term investments with original terms to maturity of three months or less to be cash equivalents.

FLOW THROUGH SHARE ISSUANCE

The Corporation finances a portion of its exploration program through the issuance of flow-through shares. Under the terms of the flow-through share agreements, and as provided for under the Income Tax Act, the tax attributes of qualifying exploration costs incurred by the Corporation are renounced to subscribers. To recognize the foregone tax benefits to the Corporation, the amount for which the shares are issued is reduced by the tax effect of the tax benefits renounced to subscribers at the time the renunciation documents are filed with the tax authorities.

MEASUREMENT UNCERTAINTY

The preparation of consolidated financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions and to use judgment regarding assets, liabilities, revenues and expenses. Accordingly, actual results may differ from those estimated amounts.

Recorded amounts for depletion and depreciation, asset retirement obligations and abandonment costs, the impairment of oil and natural gas properties and amounts used for the ceiling test and impairment calculations and based on estimates of oil and natural gas reserves and future costs required to develop those reserves. By their nature, these estimates of reserves and the related future cash flows and costs are subject to measurement uncertainty, and the effect on the consolidated financial statements of future periods could be significant.

NEW ADOPTED ACCOUNTING STANDARDS

Effective January 1, 2007, the Company adopted the following new Canadian Institute of Chartered Accountants ("CICA") Handbook sections:

a. Section 1530, Comprehensive Income;

b. Section 3251, Equity;

c. Section 3855, Financial Instruments – Recognition and Measurement; and

d. Section 3865, Hedges

These new accounting standards provide requirements for the recognition and measurement of financial instruments and the use of hedge accounting. The standards have been adopted prospectively and, therefore, the prior periods have not been restated. Comprehensive income CICA Handbook Section 1530 establishes standards for reporting and presenting comprehensive income and other comprehensive income. Comprehensive income is defined as the change in equity from transactions and other events from non-owner sources and other comprehensive income, which is comprised of gains and losses that are recognized in comprehensive income but excluded from net earnings.

The Company also adopted Section 3251 – Equity which establishes standards for the presentation of equity and changes in equity during the reporting period, effective for fiscal years beginning January 1, 2007.

Financial instruments and derivatives CICA Handbook Section 3855 prescribes when a financial asset, financial liability or non-financial derivative is to be recognized on the balance sheet and at what amount, requiring fair-value or cost-based measures under different circumstances. All financial instruments must be classified as one of the following five categories: loans and receivables, held-to-maturity investments; held-for-trading instruments; available -for-sale financial assets; or other financial liabilities. All financial instruments, with the exception of loans and receivables, held-to-maturity investments and other financial liabilities are reported on the balance sheet date at fair value.

Subsequent measurement and changes in fair value will depend on their initial classification. Available -for-sale financial assets are measured at fair value and unrealized gains or losses resulting from changes in fair value are recorded in other comprehensive income until the investment is de-recognized or impaired, at which time the amounts would be recognized as earnings.

Hedges CICA Handbook Section 3865 provides alternative treatments to Section 3855 for entities which choose to designate qualifying transactions as hedges for accounting purposes. It replaces and expands on Accounting Guideline 13 "Hedging Relationships" and the hedging guidance in section 1650 "Foreign Currency Translation" by specifying how hedge accounting is applied and what disclosures are necessary when it is applied.

The application of all of the aforementioned handbook sections did not have an impact on the Corporation's financial statements.

SHARE PURCHASE WARRANTS

The Corporation estimated the fair value of share purchase warrants that were issued. Fair value is estimated using the Black-Scholes method. When exercised the fair value is added to share capital to represent the cost to the Company of issuing the warrants.

NEW ACCOUNTING PRONOUNCEMENTS

Effective January 1, 2008, the Corporation will be required to adopt the CICA Handbook Section 1506 - Accounting Changes that provides expanded disclosures for changes in accounting policies, accounting estimates and corrections of errors. Under the new standard, accounting changes should be applied retroactively unless otherwise permitted or where the effect is impracticable to determine. As well, voluntary changes in accounting policy are made only when required by a primary source of GAAP or the change results in more relevant and reliable information.

As of January 1, 2008, the Corporation will be required to adopt two new CICA standards, Section 3862 – Financial Instruments – Disclosures, and Section 3863 – Financial Instruments – Presentation, which will replace Section 3861 – Financial Instruments – Disclosure and Presentation. The new disclosure standard increases the emphasis on the risks associated with both recognized and unrecognized financial instruments and how those risks are managed. The new presentation standard carries forward the former presentation requirements.

As of January 1, 2008, the Corporation will be required to adopt CICA Handbook Section 1535 – Capital Disclosures, which requires entities to disclose objectives, policies and processes for managing capital, and in addition, whether the entity has complied with any externally imposed capital requirements. The Company is assessing the impact of this new standard on its financial statements and anticipates that the main impact will be in terms of additional disclosures required.

2. PROPERTY, PLANT, AND EQUIPMENT

	December 31, 2007		
	Cost	**Accumulated Depletion and Depreciation**	**Net**
Petroleum and Natural Gas	**$ 32,501,687**	**$ (11,866,980)**	**$ 20,634,707**
Furniture and Fixtures	**103,325**	**(55,261)**	**48,064**
Total	**$ 32,605,012**	**$ (11,922,241)**	**$ 20,682,771**

	December 31, 2006		
	Cost	Accumulated Depletion and Depreciation	Net
Petroleum and Natural Gas	$ 21,659,267	$ (8,528,679)	$ 13,130,588
Furniture and Fixtures	80,275	(39,699)	40,576
Total	$ 21,739,542	$ (8,568,378)	$ 13,171,164

No interest or general and administrative expenses were capitalized during the period. Unproven property costs of $2,329,277 (December 31, 2006 - $1,249,477) have been excluded from capitalized costs subject to depletion.

The Corporation performed a ceiling test calculation as at December 31, 2007. The table below summarizes the benchmark prices for the next five years used by the external engineering firm in preparing the Corporation's reserve report. No write-down was required for the year ended December 31, 2007 based on the expected realized future commodity prices.

Year	Alberta AECO-C (C$ / MMBTU)	Edmonton Par Price (C$ / bbl)
2008	$ 6.51	$ 88.17
2009	$ 7.22	$ 84.54
2010	$ 7.69	$ 83.16
2011	$ 7.70	$ 81.26
2012	$ 7.61	$ 80.73
2013	$ 7.78	$ 81.25
2014	$ 7.96	$ 82.88
2015	$ 8.14	$ 84.55
2016	$ 8.32	$ 86.25
2017	$ 8.51	$ 87.98

Escalation rate of 2.0% thereafter

3. DEMAND OPERATING FACILITIES

Facility A is a revolving operating demand loan with a maximum limit of $7,750,000. Facility B is a non-revolving acquisition/development demand loan that provides an additional $2,250,000 of financing. Interest is at prime plus 0.75% per annum for Facility A and prime plus 1.0% per annum for the Facility B. At December 31, 2007 the balance owing on the current loan was $0 (2006 - $375,000).

The facilities are secured by $20,000,000 floating charge debenture over all the Corporation's assets with a negative pledge and undertaking to provide fixed charges on the Corporation's major producing properties at the request of the bank. The facilities are repayable on demand.

4. ASSET RETIREMENT OBLIGATION

The total future asset retirement obligation was estimated based on the Corporation's net ownership in all wells and facilities, estimated costs to reclaim and abandon the wells and the estimated timing of costs to be incurred in future periods. The Corporation has estimated the net present value of its asset retirement obligation to be $539,840 (December 31, 2006 - $391,648) as at December 31, 2007. A credit adjusted risk free rate of 5.36 percent (2006 - 5.36 percent) and an inflation rate of 2 percent were used to calculate the fair value of the asset retirement obligation. The gross, undiscounted future obligation for the Corporation is $981,014 ($711,198 - 2006).

A reconciliation of the asset retirement obligation is provided below:

	Year Ended December 31, 2007	Year Ended December 31, 2006
Balance, beginning of period	**$ 391,648**	$ 217,915
Liabilities incurred in period	**128,708**	142,379
Liabilities settled in period	**–**	(432)
Accretion Expense	**19,484**	31,786
Balance, end of period	**$ 539,840**	$ 391,648

5. SHARE CAPITAL

A) CLASS A COMMON SHARES

	Year Ended December 31, 2007		Year Ended December 31, 2006	
	Shares	**Amount**	Shares	Amount
Balance, beginning of period	**23,685,291**	**$ 7,559,760**	21,438,924	$ 5,558,614
Exercise of options (iii)	**510,000**	**444,714**	1,180,000	1,042,909
Exercise of warrants (iv)	**2,758,620**	**2,495,758**	1,066,367	959,737
Unit private placement (i)	**5,260,870**	**5,209,568**	–	–
Flow through shares (ii)	**1,500,000**	**3,000,000**	–	–
Share issue costs				
(net of tax effect of $277,221) (i) (ii)	**–**	**(762,817)**	–	(1,500)
Balance, end of period	**33,714,781**	**$ 17,946,983**	23,685,291	$ 7,559,760

(i) In the first quarter 2007, the Corporation issued 5,260,870 units priced at $1.15 per unit. Each unit consisted of one Common Share and one-half of one common share Purchase Warrant. Each whole common share Purchase Warrant entitles the holder to purchase one additional Common Share at an exercise price of $1.75 per Common Share until July 25, 2008. The warrants have been ascribed a fair value of $0.32 using the Black-Scholes pricing model assuming a risk-free interest rate of 4.01%; weighted average life of 1.5 years; dividend yield of nil; and expected volatility rate of 70%. Primary Capital Inc., the agent, was paid a cash commission of $423,500, and was granted non transferable Broker Warrants to acquire 368,260 Common Shares at an exercise price of $1.15 until July 25, 2008 and to acquire one half of one common share Purchase Warrant. Each whole common share Purchase Warrant entitles the holder to purchase one additional Common Share at an exercise price of $1.75 per Common Share until July 25, 2008. These Broker Warrants have been recorded as share issue costs estimated at $129,264 using the Black-Scholes pricing model assuming a risk-free interest rate of 4.01%; weighted average life of 1.5 years; dividend yield of nil; and expected volatility rate of 70%. Legal and other costs incurred, related to this private placement, were $116,779.

(ii) In the second quarter 2007, the Corporation issued 1,500,000 flow - through shares priced at $2.00. Primary Capital Inc. was paid a cash commission of $225,000, and was granted non transferable Broker Warrants to acquire 97,500 Common Shares at an exercise price of $2.00 until July 25, 2008. These Broker Warrants have been recorded as share issue costs estimated at $36,198 using the Black-Scholes pricing model assuming a risk-free interest rate of 4.047%; weighted average life of 1.25 years; dividend yield of nil; and expected volatility rate of 58%. Legal and other costs incurred, related to the issuance of these flow - through shares, were $61,935. As part of the flow – through share offering, Petro-Reef has renounced to investors and must incur $3,000,000 in eligible exploration expenditures on or before December 31, 2008. The actual renunciation was filed with the government in early Q1 – 2008 and, as a result, will be accounted for during that period. As at December 31, 2007, Petro-Reef incurred approximately $3,432,000 in exploration expenditures. As a result, Petro-Reef has met its obligation under its flow – through share offering.

(iii The increase in share capital as a result of the exercise of stock options is comprised of cash received of $255,000 and compensation expensed previously of $189,714.

(iv) The increase in share capital as a result of the exercise of warrants is comprised of the amount of cash received of $1,931,038 and the reclassification to share capital of the ascribed value related to the warrants exercised of $564,720. These warrants were issued by the Corporation under financings that closed in August and September of 2005.

B) WARRANTS

	Year Ended December 31, 2007 Exercise Price	Number	Amount
Balance, beginning of period	$ 0.70	2,933,620	$ 606,719
Exercise of warrants	0.70	(2,758,620)	(564,719)
Expiry of warrants	0.70	(175,000)	(42,000)
Unit private placement ((note 5(1)(i))	1.75	2,630,435	840,429
Balance, end of period	$ 1.75	2,630,435	$ 840,429

	Year Ended December 31, 2006 Exercise Price	Number	Amount
Balance, beginning of period	$ 0.70	3,999,987	$ 820,000
Exercise of warrants	$ 0.70	(1,066,367)	(213,281)
Balance, end of period	$ 0.70	2,933,620	$ 606,719

C) BROKER WARRANTS

	Year Ended December 31, 2007 Exercise Price	Number	Amount
Balance, beginning of period	$ –	–	$ –
Unit private placement (note 5(a)(i))	1.15	368,260	129,264
Flow through shares (note 5(a)(ii))	2.00	97,500	83,421
Balance, end of period	$ 1.33	465,760	$ 212,685

D) CONTRIBUTED SURPLUS

	Year Ended December 31, 2007	Year Ended December 31, 2006
Balance, beginning of period	$ 570,609	$ 534,308
Stock-based compensation recognized in the period	1,236,299	481,709
Adjustments for stock options exercised in the period	(189,714)	(445,408)
Expiry of warrants	42,000	–
Balance, end of period	$ 1,659,194	$ 570,609

E) PER SHARE AMOUNTS

Earnings per common share are calculated using the weighted average number of common shares outstanding during the period. A reconciliation of the denominators used in the per share calculation is outlined below:

	Year Ended December 31, 2007	Year Ended December 31, 2006
Basic weighted average common shares	32,198,063	22,109,165
Effect of diluted options and warrants	2,018,682	3,304,499
Diluted weighted average common shares	34,216,745	25,413,664

6. STOCK BASED COMPENSATION

The Corporation has a stock option plan for directors, officers and key employees. The exercise price of each option equals the market price of the Corporation's stock on the date of grant. Options vest after one year and expire after a maximum period of five years from the date of issue.

A summary of the status of the Corporation's stock option plan as of December 31, 2007 and December 31, 2006 and changes during the period are presented below:

	Year Ended December 31, 2007		Year Ended December 31, 2006	
	Weighted Number of Options	**Weighted Average Exercise Price**	Weighted Number of Options	Weighted Average Exercise Price
Balance beginning of year	**1,980,000**	**$ 0.89**	2,120,000	$ 0.50
Granted	**1,580,000**	**$ 1.48**	1,040,000	$ 1.24
Exercised	**(510,000)**	**$ 0.50**	(1,180,000)	$ (0.50)
Balance end of period	**3,050,000**	**$ 1.18**	1,980,000	$ 0.89
Exercisable end of period	**1,470,000**	**$ 1.02**	940,000	$ 0.50

Compensation costs of $1,236,299 (2006 - $481,709) has been recognized for stock options granted during the year.

The weighted average fair value of each option granted during the year ended December 31, 2007 is estimated on the date of grant using the Black-Scholes options pricing model with the following weighted average assumptions:

	2007	2006
Total Stock-Based Compensation Fair Value of Options Issued during the Year	**$ 1,202,993**	$ 811,200
Fair value of options granted	**$ 0.76**	$ 0.78
Risk-free interest rate (%)	**4.0%**	4.0%
Expected life (years)	**3**	3
Expected volatility (%)	**87%**	103%
Expected dividend yield (%)	**Nil**	Nil

7. INCOME TAXES

The following table summarizes the temporary differences, which give rise to the future income tax liability at December 31:

	2007	2006
Future income tax liabilities		
Property, plant and equipment	**$ 927,647**	$ 801,585
Future income tax assets		
Asset retirement obligation	**(137,659)**	(113,578)
Share issue costs	**(251,262)**	(53,495)
Balance, end of year	**$ 538,726**	$ 634,512

The income tax provision differs from the amount computed by applying the expected income tax rate of 33.12 percent (2006 – 34.49 percent) to earnings before taxes. The reasons for this difference are as follows:

		2007		2006
Earnings (loss) before taxes	$	176,114)	$	272,745
Expected tax rate		32.12%		34.49%
Expected tax recovery at combined federal and provincial rates	$	(56,568)	$	94,070
Crown royalties and production taxes		–		177,259
Alberta royalty tax credit		–		(44,314)
Resource allowance		–		(119,458)
Stock based compensation		397,099		166,141
Decrease in future taxes due to tax rate reduction		(152,327)		(69,139)
Other		(6,768)		3,126
Income Tax Expense	$	181,436	$	207,685

8. COMMITMENTS

The present office lease agreement expires on September 30, 2011. Future lease payments to the end of the lease term under the company's office lease are as follows:

2008	$80,922
2009	$84,258
2010	$86,762
2011	$65,070

9. FINANCIAL INSTRUMENTS

FAIR VALUE

Financial instruments include bank indebtedness, accounts receivable, and accounts payable and accrued charges. At December 31, 2007, the fair market value of the financial instruments approximated their carrying value due to the short-term maturity of these instruments.

CREDIT RISK

Substantially all of the Company's accounts receivable are due from customers in the oil and gas industry and are subject to normal industry credit risks.

INTEREST RATE RISK

The Company is exposed to interest rate cash flow risk to the extent that its bank loans are at a floating rated on interest. The related disclosure regarding these debt instruments is included in note 3 of these financial statements.

10. RELATED PARTY TRANSACTIONS

All related party transactions are in the normal course of operations and have been measured at the agreed to exchange amounts, which is the amount of consideration established and agreed to by the related parties. During the year, the Corporation purchased engineering services in the amount of $1,505,542 (2006 - $1,051,073) from a company controlled by a Director of the Corporation. The Corporation also purchased professional services in the amount of $220,367 (2006 - $78,086) from a law firm which a Director of the Corporation is a partner of.

11. SUBSEQUENT EVENTS

On February 8, 2008, Petro-Reef announced it has closed on the acquisition of production, along with undeveloped lands and a 10% working interest in the Petro-Reef operated Alexander Qui-Barre natural gas facility for cash consideration of approximately $10,400,000, subject to final closing adjustments. The acquisition has an effective date of January 1, 2008. To assist in financing the acquisition, Petro-Reef amended its credit facility with the National Bank of Canada whereby the Bank increased the existing Revolving Operating Demand Loan from $7,750,000 to $13,500,000 and the Non-Revolving Acquisition Demand Loan from $2,250,000 to $4,000,000.

COMPANY INFORMATION

DIRECTORS AND OFFICERS

Joseph Werner [3][5]
Chief Executive Officer
President & Director
Calgary, Alberta

Theodore M. Donhuysen [4][5]
Vice-President Exploration
& Production
Chief Operating Officer & Director
Calgary, Alberta

John R. Pantazopoulos [5]
Vice President Finance
Chief Financial Officer
Calgary, Alberta

Richard W. DeVries [1][2]
Director
Freeport, The Bahamas

Jack P. Donhuysen [1][2][4]
Director
Calgary, Alberta

Alan P. Hallman [2][3]
Director
Calgary, Alberta

Peter A. Lubey [4]
Director
Calgary, Alberta

Gary W. Coleman
Assistant Secretary
Calgary, Alberta

Robert N. Maertens-Poole
Director
Calgary, Alberta

R. Greg Powers [3]
Director, Corporate Secretary
Calgary, Alberta

Huba A. Sebo [1]
Director
Calgary, Alberta

Dennis K. Ulrich
VP Shareholder Relations
Southern Alberta
Medicine Hat, Alberta

HEAD OFFICE

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AUDITORS

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Chartered Accountants
3100, 111 - 5th Avenue S.W.
Calgary, Alberta T2P 5L3

BANK

National Bank of Canada
301 – 6th Avenue S.W.
Calgary, Alberta T2P 4M9

REGISTRAR AND TRANSFER AGENT

CIBC Mellon Trust Corporation
600, 333 - 7th Avenue S.W.
Calgary, Alberta T2P 2Z1

STOCK LISTING

TSX Venture Exchange
Trading Symbol: PER

(1) Member of the Audit Committee

(2) Member of the Compensation Committee

(3) Member of the Governance Committee

(4) Member of the Reserves Committee

(5) Member of the Management Committee

petro-reef resources ltd.

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